Domestic Petroleum Council
Independent Petroleum Association of America

December 18, 1998

Mr. Todd McCutcheon
Chief, Policy & Management Improvement
Minerals Management Service
U.S. Department of the Interior
P. O. Box 25165 - MS 9200
Denver, CO 80225

Dear Mr. McCutcheon:

We are writing to express the strong support of the Independent Petroleum Association of America (IPAA) and the Domestic Petroleum Council (DPC) for the Minerals Management Service's (MMS) subsea gathering and transportation initiative described in the MMS notice at 63 FR 56217 (October 21, 1998).

Our Supplemental Comment filed in response to the MMS' inquiry in the Federal Register, 63 FR 38353 (July 16, 1998), explained that the current regulations are ill suited to identify the true function of subsea pipeline facilities. We were therefore very gratified that the MMS convened the November 15, 1998 workshop and the Staff stated at the workshop their belief that a new policy is appropriate in this area.

The Gulf of Mexico is a critical basin for the domestic petroleum industry. As shown in Arthur Andersen's recent report entitled "1998 U.S. Oil & Gas Industry Outlook Survey Results", independents believe the deepwater Gulf has the greatest potential for new discoveries of crude oil and natural gas reserves. The same report also shows that independents assign a high ranking to the O.C.S. Gulf for new discoveries of crude oil and natural gas reserves. However, exploitation of such discoveries will require very substantial capital expenditures and the use of new and innovative technologies. In the current climate of depressed commodity prices, it is especially important to recognize that new subsea pipeline technologies can play a critical role in moving oil and gas from offshore leases to market centers in a safe and cost effective manner.

DPC and IPAA actively participated in the workshop and the legal panel included a company representative. We joined with the American Petroleum Institute (API) in recommending that the MMS create a "safe-harbor" category, where movements of deepwater[1] production would be clearly entitled to transportation cost allowances.

Independents, who often rely on project financing by lenders or investors for development, need a safe-harbor to ensure timely project development occurs. Requiring case-specific approval would unduly delay project funding and would place independents at a competitive disadvantage to those producers who do not utilize external financing for development activities.

At the workshop, the technical panel demonstrated that new technologies permit subsea facilities to replicate on the sea floor the production accumulation and transportation functions traditionally performed on the O.C.S. by a combination of surface structures and linked pipelines. However, measurement and treatment functions still must be performed on "host" surface structures[2] downstream of the subsea point where production is aggregated and production enters the pipeline. Consequently, the traditional MMS policy that labels the movement by pipeline of production not treated to marketable condition as "gathering" leads to an arbitrary and discriminatory result, where the producer is denied any cost allowance for moving deepwater production -- frequently over very long distances -- to the host surface structure. [3] We strongly believe this outcome was not contemplated when the current regulations were adopted in 1988 and it is contrary to law.

To remedy this problem, we recommend the MMS adopt a policy incorporating the following criteria into a safe-harbor transportation allowance for deepwater production:

- **Deepwater production moving through a subsea manifold to a surface structure located on a lease not adjacent to the producing lease or unit should qualify for a safe-harbor allowance.** The transportation allowance should apply to all costs incurred after the production enters the manifold. As explained by the technical panel, the manifold is not a production facility, but rather serves as a header for the movement of accumulated production

[1] Deep water should be defined at 200 meters of water or more just as it is in the Deepwater Royalty Relief Act. Water depth should be determined by either or both of the subsea production well tied to the manifold or the manifold itself.

[2] Surface structures include both fixed and floating structures, including fixed platforms, compliant towers, spars, floating production systems and tension leg platforms.

[3] The Supplemental Comments filed by IPAA and DPC explain in detail why this outcome is arbitrary and discriminatory and point out analogous instances where transportation allowances have been granted when physical or other factors prevented separation or treatment functions from being performed upstream of the pipeline at issue.

through the downstream pipelines. Movement of deepwater production through those pipelines to a non-adjacent lease should be considered transportation per se, because such movement is a costly endeavor and clearly not a matter of the lessee's operational convenience.

- **Deepwater production moving from subsea "daisy-chain" wells to a surface structure on a lease not adjacent to the producing lease or unit should also qualify for a safe-harbor allowance**. As explained at the workshop, installation of a manifold is not necessary when wells can be linked in seriatim. In this case, the transportation function includes only the flow through the linking pipelines. The same factors as are discussed above for the manifold configuration support a cost allowance for these facilities.

- **Deepwater production moving from a single subsea well to a surface structure on a lease not adjacent to the producing lease or unit should also qualify for a safe-harbor allowance**. Here only the pipeline linking the subsea wellhead to the host facility would qualify for a cost allowance. Again, the same factors as are discussed above for the manifold arrangement justify a cost allowance for these facilities.

- **Deepwater production (whether produced from a subsea well or not) moving from a surface structure to a host facility not adjacent to the lease or unit where the surface structure is located should also qualify for a safe-harbor allowance**. A cost allowance should be provided whenever deepwater production is moved in bulk form downstream of a surface structure where the production is not separated and/or treated to marketable condition to a host facility not adjacent to the lease or unit where the upstream surface structure is located. We believe the upstream surface structure is performing an accumulation function and that the movement by pipeline downstream of that structure is transportation. Even though subsea production may not be involved, the above-discussed operational factors, e.g. the movement of bulk production a substantial distance away from the lease, justify a cost allowance.

The MMS should also provide a cost allowance for other types of movements of bulk production from any offshore lease that extend from the lease to a point not adjacent to the lease or unit. In this case, the lessee would be required to show that it is not operationally feasible, practical, or safe to separate and/or treat the production to marketable condition before it enters the pipeline.[4] The lessee would apply for this allowance on a case by case basis.

[4] See *Exxon Company, U.S.A.*, MMS-VSD-OG93-0075 (December 29, 1994), where the MMS allowed a transportation allowance for oil in bulk stream which moved to shore from offshore platforms for processing and handling.

For purposes of both the safe-harbor and the case by case determination, the marketable or non-marketable condition of the product being transported and the location of the facility measurement point should not be considered. However, the lessee should not receive an allowance for the allocated cost of moving non-marketable substances such as free water through the pipeline.

Following the workshop, an MMS representative inquired whether a black-and-white, facility-specific test could be devised to define the scope of the transportation allowance. We believe that a litmus test should not be created. For example, while the deepwater temperatures approach freezing and present significant operational challenges, temperature of the transported product is not an appropriate criterion, because technologies may be employed to insulate or heat the production in the pipeline. Likewise, while increased pipeline wall thickness is often associated with deepwater production, new metallurgic technology will reduce required wall thickness over time. Policies that focus on specific facility characteristics are destined to failure due to the rapidly changing nature of the technologies being employed.

In conclusion, IPAA and DPC strongly support MMS' subsea initiative. We very much appreciate the very significant resources MMS is committing to work with industry in this area. We look forward to a further constructive exchange of information and ideas on this very important topic.

Sincerely,

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